

United States  
**COURT OF APPEALS**  
for the Ninth Circuit

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HUGH H. EARLE, Former Collector of Internal Revenue for the District of Oregon,

*Appellant,*

v.

ANGELA MACEOY, WOODLAW, OTIS O. JAMES and STEPHEN W. MATTHIEU, Executors of the Estate of G. T. Woodlaw, Deceased,

*Appellees.*

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*On Appeal from the Judgment of the United States District Court for the District of Oregon*

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**APPELLEES' BRIEF**

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**APPELLEES' BRIEF**

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**SUMMARY OF ARGUMENT**

Appellant presents an argument which would more properly be addressed to the District Court. The sole issue here presented is whether the factual determination by the Court below is clearly erroneous.

The testimony establishes that the decedent, a man 80 years of age, conceived a plan of liquidation of the corporation shortly after the death of the adopted son whom he expected to succeed him. The reason for the

liquidation was that he was getting too old to run the business.

In pursuance of his plan of liquidation, the decedent, who actively and personally managed his own affairs and those of the corporation, caused the corporation to sell some and attempt to sell all the rest of its capital assets, consisting of downtown buildings and unimproved lots. Those which he did not succeed in selling were a half-block of downtown property for which he was asking \$1,000,000. In an effort to make that property more attractive to purchasers, he had established good tenants in two of the three buildings, instead of operating them through the Woodlaw Investment Co. or another corporation. This other corporation, in which he was the sole stockholder, had operated one of the buildings, and was sold to the new lessees.

The distribution which is here involved was made in pursuance of that plan of liquidation, in order to reduce the capital of the corporation as called for by its contracted activities. It served no individual purpose of Colonel Woodlaw, other than his desire to liquidate his holdings because of his age. In fact, it caused the imposition of a tax which would not otherwise have been incurred. The distribution falls clearly within the definition of a distribution in partial liquidation (I.R.C. 1939, § 115(i)) and was not essentially equivalent to the distribution of a taxable dividend. It was made for legitimate business purposes of the corporation, and as part of a plan of complete liquidation which was undertaken and partially consummated.

The cases cited by the appellant do not support his position in that not one of them involves a reversal of the factual determination of the trial court. The authorities demonstrate that the trial court herein was justified in its holding that the distribution herein was not essentially equivalent to a dividend, and the judgment of the court below should be affirmed, because not clearly erroneous.

## **ARGUMENT**

### **The Issue Presented by This Appeal**

Although paying lip-service to the rules regarding appellate review, the Brief of appellant Earle evidences a rather basic misconception of the issue before this Court. He presents a purely factual argument, depending in part upon inferences and guesses from the oral testimony which he desires to draw, but which the District Court did not, in an attempt to convince this Court that the purchase and retirement of its stock by Woodlaw Invesment Co. was a transaction essentially equivalent to the distribution of a taxable dividend.

Whether or not the transaction was such a dividend was the sole issue of fact presented to the District Court for determination (R. 34-35). After consideration of the testimony and the documentary evidence, the District Court came to the factual conclusion that the transaction was not equivalent to the distribution of a taxable dividend, but that its net effect was a distribution of capital assets. The only issue before this Court is

whether or not this factual determination by the District Court was "clearly erroneous."

The scope of appellate review in such circumstances has been frequently stated by this Court. Thus, in *Earle v. W. J. Jones & Son*, 200 F2d 846, 847 (CA 9, 1952), the Court stated:

"The finding of fact that the advances were loans must be sustained unless clearly erroneous. Contrary to contentions of appellants, the oral testimony in this case is not in conflict with the documentary evidence so as to render the testimony extremely doubtful and thus permit us to disregard the finding and draw our own inferences from the record. The oral testimony was substantially consistent with the undisputed facts, and we must apply it with "due regard \* \* \* to the opportunity of the trial court to judge of the credibility of the witnesses." And we should be reluctant to disturb the finding of the trial court where, as here, the question whether the advances gave rise to debts or to a proprietary interest depends upon the determinative intent of the parties to the critical advances. 'Findings as to the design, motive and intent with which men act depend peculiarly upon the credit given to witnesses by those who see and hear them.'"

In *Toor v. Westover*, 200 F2d 713, 717 (CA 9, 1952), the Court held:

"We are unable to say that the particular findings of the District Court which we have thought to be crucial in this case are clearly erroneous because, upon an examination of the entire evidence, we are not left with a 'definite and firm conviction that a mistake has been committed.' *United States v. United States Gypsum*, 1948, 33 U. S. 364, 68 S. Ct. 525, 542, 92 L. Ed. 746: see

Grace Bros., Inc., v. Commissioner, 9 Cir., 1949, 173 F2d 170, 173-174."

As appellant recognizes, the question presented by this appeal is one of fact (Appellant's Br., p. 13). We therefore set forth a statement of the evidence before the District Court on which it relied in reaching its conclusion, most of which testimony the appellant has ignored in presenting his argument.

### **Statement of Facts**

G. T. Woodlaw was substantially the sole stockholder of Woodlaw Investment Co. (Supp. R., 128). In 1946, he was a man of 80 years of age. (R. 59, 82). Aside from his wife, the only relative close to him was Graham Casteel Woodlaw, (R. 81, 119) a grandson whom he had adopted as a son. (R. 79, 116)

Colonel Woodlaw actively and personally managed the affairs of the Woodlaw Investment Co., (R. 59, 64, 110) which was engaged in the owning and operating of real estate in the City of Portland, Oregon. (R. 32) It was his hope that his son would some day assist him in the management of the business. (R. 105, 112) Unfortunately, the son was killed in an airplane crash while in military service in November, 1945. (R. 79) The death of his son was a "crushing blow" to Colonel Woodlaw. (R. 80, 116) In the latter part of 1945 he had cancelled existing plans for expansion of the business, (R. 76) and about the month of December, 1945, (R. 105) as a result of the death of his son, (R. 112) he formulated a plan of liquidating the business. (R. 115)

At about the time of the son's death, the Woodlaw Investment Co. owned a parcel of real estate known as the Hamilton Building, (R. 84) a parcel known as the Gerlinger Building, (R. 92) some unimproved lots, (R. 103-104) and a half block of downtown Portland property consisting of three distinct buildings—the Fourth Avenue Hotel Building, the Circle Theater Building, and the Maguire Building. (R. 106) Circle Theater Building was leased by the Circle Theater Company, a corporation substantially owned by Colonel Woodlaw. (R. 107)

In October, 1945, (R. 104) the Woodlaw Investment Company sold the Gerlinger Building, (Exh. 12, R. 98)\* for a price that does not appear in the record. Colonel Woodlaw had already decided at that time to contract his activities. (R. 70) In May of 1946, (Exh. 11, R. 96) pursuant to the plan of liquidation, the Hamilton Building was sold on contract for \$80,000. (R. 103-104) In February of 1946, the corporation sold the Failing Street lots for about \$2200, (R. 103, 104) and in April, 1946, (R. 103, 104) some other unimproved lots were sold for \$9,000, also in furtherance of the liquidation plan.

In 1946 the corporation leased the Fourth Avenue Hotel Building to Morris Rogoway. (R. 67) In 1947, Colonel Woodlaw sold the stock in the Circle Theater Company to Theodore R. Gamble, who had been at-

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\* According to the testimony of witness Matthieu (R., 104) and the agreed facts (R., 33), the Gerlinger Building was sold in October, 1945, before the death of Colonel Woodlaw's son. The corporate resolution, however, indicates that the transaction was not approved by the Board of Directors until January 25, 1946 (R. 98-99).

tempting to work out a deal with him in regard to this property since 1940. (R. 56) He explained to Gamble that after all the years of discussing the deal, he was finally ready to go through with the transaction because he was liquidating all his assets and had taken substantial action in that direction. (R. 59-60) At the time of this sale, a long-term lease was entered into between the new owners of the Circle Theater Company and the Woodlaw Investment Company. Colonel Woodlaw explained that he did this in order to establish good tenants in the property so as to make it attractive to buyers. (R., 108)

During the year 1947 Colonel Woodlaw attempted to make a sale of the half-block comprising three buildings to Morris Rogoway for \$1,000,000. (R., 68-69) In 1948 he also attempted to sell the half-block to Harry A. Caraplis for the same price. (R., 72-73, 114, 117-118) No deal was ever consummated, and Colonel Woodlaw continued in his efforts to liquidate this property until the time of his death (R. 77, 119) in 1950. (R., 28) The only other corporate property was a couple of lots on 25th or 26th and Marshall. (R., 106) Colonel Woodlaw discussed giving these lots to Shriner's Hospital, but apparently nothing was ever done with respect to it. (R., 64)

Thus, it appears that of five major parcels of real estate, and three sets of minor parcels of unimproved realty, the Woodlaw Investment Company sold two of the three unimproved sets, sold two of the five major parcels, leased two of the remaining three parcels, one

of them being a long-term lease "to establish good tenants in property that would make it attractive to a buyer or buyers," and entered into negotiations with at least two different prospective purchasers for the sale of the three remaining parcels for \$1,000,000. All of these transactions were clearly identified as being undertaken pursuant to the plan of liquidation of the assets of the corporation which had been adopted. (R. 59-60, 68-69, 72, 76-77, 103-104, 117)

On February 5, 1946, the corporation adopted a resolution that the authorized capital stock of the corporation be reduced from 3500 shares to the 2800 shares outstanding. (R. 99-100) On February 9, 1946, a resolution was adopted that the corporation purchase from Colonel Woodlaw 1400 shares of stock and retire them. (R. 100-101) The consideration for this purchase was \$226,000, which was paid by a cancellation of debts owed to the corporation by Col. Woodlaw of \$40,225.15 and a cash payment of \$163,000 in the year 1946, a cash payment of \$2000 in 1947, and the balance in 1949 by the transfer to Colonel Woodlaw of the corporation's equity in the contract for the sale of the Hamilton Building. (R. 29, 33)

On the basis of the foregoing facts, the District Court found as a fact that the transaction by which the corporation purchased the stock from Colonel Woodlaw "was not a transaction equivalent to the distribution of a taxable dividend within the meaning of Section 115(g) of the Internal Revenue Code. The net effect of the distribution to the said G. T. Woodlaw was a

distribution of capital assets." (R., 50) The Court also found (R., 50):

"That there was in existence at the time of the transaction in 1946 involving the sale of the stock by the decedent, G. T. Woodlaw, to Woodlaw Investment Co. a legitimate business purpose therefor and Section 115(g) of the Revenue Act is inapplicable."

### **The Facts Support the District Court's Judgment**

Appellant complains that it "should not have to conjecture" about the basis for the District Court's decision, but that the Court fails to indicate the reason for allowing the claimed refunds. (Appellant's Br., p. 23) In view of the fact that appellant stipulated in the pre-trial order that the sole issue of fact to be determined was the equivalence of the transaction to a taxable divident, (R. 34) and that he requested no additional findings about the points on which he now conjectures, appellant is in a poor position to complain. Since he argues that "the statute is aimed at the result," and that the basic criterion is "the net effect of the distribution," (Appellant's Br., p. 23) it is a trifle difficult to determine what fault he finds with a factual finding that the net effect of the transaction was a distribution of capital assets. (R. 50)

Nevertheless, on the foregoing statement of facts, we feel that the trial judge was well justified in concluding that Col. Woodlaw was a man advanced in years, who had expected his son to step into the business and take it over upon his return from service. When the

son died, it became apparent that there would be no replacement for Col. Woodlaw, who was the active manager as well as sole stockholder of the corporation, and he thereupon determined that the business should be liquidated.

At the time this intention was formed, the corporate assets consisted of five buildings, and three sets of unimproved lots. The corporation actively operated these buildings, with the exception of the Circle Theater Building, which was leased by the Circle Theater Company, a corporation whose stock was owned by Col. Woodlaw. Within a year of his decision to liquidate the assets of the business, Col. Woodlaw had succeeded in disposing of two of the buildings and two of the three sets of lots. The following year, he also sold the Circle Theater Company to Mr. Gamble, who had been attempting for years to work out a deal for that business without any success. The purpose of this transaction was to establish a desirable tenant in the Circle Theater Building so as to make it attractive to a prospective purchaser. He also leased the Fourth Avenue Hotel Building, and it may fairly be inferred that he was actuated by the same business motive in that transaction.

Appellant makes much of the finding by the Court that the Woodlaw Investment Company continued in the same type of business until the time of trial. (R. 129) It is apparent from the foregoing review, however, that while the corporation was still in the business of owning and operating real estate, the nature and emphasis of the corporation's activities was being changed from

active operation of the properties to a mere holding company which was endeavoring to liquidate its remaining assets. Moreover, the record clearly establishes that during the years 1947 and 1948, although the corporation was still in business, Col. Woodlaw engaged in at least two protracted negotiations in an effort to sell the remaining substantial assets of the corporation—the half-block comprising three buildings—for the sum of one million dollars. Had he succeeded in so doing, the corporation would have had no assets but cash and one unimproved lot. The Court will no doubt take judicial notice that purchasers for a transaction of this order of magnitude are not readily come by. There is no suggestion in the record to support appellant's insinuation (Appellant's Brief, p. 27) that the price asked may have been excessive. Mr. Rogoway, in fact, who was one of the parties with whom Col. Woodlaw negotiated, testified that he was interested in purchasing the property (R. 68) but that he and his associates eventually decided that it was too big a transaction for them (R. 69).

Certainly it cannot be said, as appellants seem to contend, that simply because Colonel Woodlaw was unable to find a purchaser of these properties for a million dollars within a few months, that there was no intention to liquidate. His efforts to "unload everything he had," in fact, continued right up to the time of his death (R. 119).

It is thus apparent that every major corporate activity from December, 1945, on, was taken with the intention of carrying out a complete liquidation of the

corporate business. Some buildings were sold, efforts were made to sell the rest, and in the meantime, responsible tenants were established in the properties in order to operate them and make them more readily salable. Although it is true that no witness directly testified that it was in pursuance of this plan of liquidation that Colonel Woodlaw's stock was purchased and retired by the corporation, we do not think that it was an unreasonable inference for the District Court to draw, in view of the fact that shortly before, 700 shares of stock, issued, but not outstanding, had been retired (Pl. Exh. No. 13, R. 99-100) and all of the other activities of the corporation were steps taken in connection with the plans of liquidation.

The Court will note that throughout the previous discussion we have used the name of decedent, Colonel Woodlaw, almost synonymously with that of the corporation. It would be futile to attempt to gloss over the fact that since decedent was substantially the sole stockholder and the active manager thereof, his intentions and purposes were necessarily those of the corporation. Nevertheless, we feel that a distinction can be drawn between corporate purposes and individual purposes, and the fact that a certain line of action serves individual purposes does not necessarily mean that it cannot serve a legitimate corporate purpose as well. In this connection, the appellant appears to wish to have his cake and eat it too—he points out that the corporation's failure to declare dividends was necessarily due to Colonel Woodlaw's decision (Appellant's Br., p. 20);

but at the same time, he asserts that there is no evidence that the corporation as such intended to liquidate because Colonel Woodlaw's intentions to liquidate cannot be taken as any evidence of such intention on the part of the corporation (Appellant's Br., p. 25).

We wish to point out to the Court the carefully considered opinion in *Keefe v. Cote*, 213 F2d 651 (CA 1, 1954), involving a distribution to substantially the sole stockholder of a corporation, wherein the Court stated, at p. 657:

"In cases such as this, in which the stockholder-taxpayer and the principal if not as a practical matter the only corporate officer are one and the same person, it is difficult, to say the least, to distinguish between corporate purposes on the one hand and stockholder purposes on the other for transaction of the kind involved. But the background for the redemption and distribution sheds some light on its purpose. As already appears the block of 248 shares was originally given to the taxpayer in settlement of his claim for salary, the purpose of the exchange of the stock for the note being a corporate one, *i.e.* to improve, or at least to remove what was considered to be an adverse reflection upon, the corporation's credit position. And the taxpayer testified that when the certificate for the 248 shares was issued to him it was understood that the corporation would redeem them when it could do so conveniently. Thus it could be found that there was a corporate purpose in issuing the shares, and it could also be found that they were redeemed in carrying out that corporate purpose."

Here, too, there was a legitimate business purpose of the corporation to be served. The sole stockholder and manager of the business was becoming too old to carry

on the active management of the business, and the "heir apparent" had met an untimely death. There being no one left to carry on the management, it was an entirely proper corporate purpose to embark upon a plan of liquidation, and in connection therewith, to reduce the capital stock from 3500 shares to 1400 shares.

As the Court stated in the case of *Commissioner v. Sullivan*, 210 F2d 607, 610 (CA 5, 1954):

"The distribution of the high-pressure leases and the drilling equipment constituted a contraction of Texon's business. When there is a contraction or shrinkage of corporate business, the need of a corporation for funds to carry on its former activities is largely eliminated. Following a contraction of its activities, and with surplus funds on hand, good business and accounting practices dictated a redemption of a portion of the corporation's capital stock. Failure to reduce its capital would have resulted in the payment of unnecessary capital-stock taxes contrary to good business practices. There were other factual considerations that entered into the decisions of the Tax Court."

### **The Factors Relied upon by Appellant**

Appellant sets forth seven factors which he asserts have been held to be determinative of the issue here presented, (Appellant's Br., Section B, pp. 14-17) all of which are asserted to be present in this case. The most important factor, and one which he here considers of overriding importance, is that of pro rata cancellation and distribution of the stock. In support of his proposition that this factor should be determina-

tive of the case, he cites the decision in *Commissioner v. Roberts*, 203 F2d 304 (CA 4, 1953), among others.

In the *Roberts* case, the Tax Court (17 T. C. 1415 (1952)) had held that a redemption of stock belonging to taxpayer was in reality a redemption of the stock of his brother's estate, and hence that the case fell under the rule that the cancellation of all of the stock of a particular shareholder was not the distribution of a taxable dividend. (See Treasury Regulations 111, Sec. 29.115-9, reproduced at Appellant's Br., p. 33) The Court of Appeals determined that the Tax Court was in error in holding that the stock belonged to the estate, since it had been transferred to the taxpayer, and reversed, taking pains to point out that there was a large and unnecessary accumulation of cash, that there was no intention to liquidate or contract the business, and that the redemption served no business purpose of the corporation (203 F2d at p. 306). In other words, the sole basis of the Tax Court's opinion having been erroneous, there was left no reason for concluding that the distribution was anything but equivalent to the distribution of a taxable dividend. The issue involved in the *Roberts* case is not present here, and the issue here was not involved in the *Roberts* case. The Court did not there find that the Tax Court had erred in its fact-finding regarding essential equivalence, but that its error was a question of law regarding ownership of the redeemed stock.

The other authorities cited by the appellant at page 15 of his Brief are not especially relevant. In the cases

of *Chandler's Estate v. Commissioner*, 228 F2d 909 (CA 6, 1955); *Vesper Co. v. Commissioner*, 131 F2d 200 (CA 8, 1942); and *Flanagan v. Helvering*, 116 F2d 937 (CA DC, 1940), the factual conclusions of the lower tribunal regarding essential equivalence to a dividend were *affirmed*. They certainly constitute no authority for contending that a pro rata distribution is sufficient ground for *reversing* the trial court's finding as clearly erroneous. In *Stein v. United States*, 62 F. Supp. 568 (Ct. Clms., 1945), by a three to two decision made a factual determination that the distribution there involved was essentially equivalent to a dividend. The Court mentioned (p. 572) that the corporation "had no thought of liquidating its operating assets, or curtailing its operations."

Appellants seem to ignore the fact that where the taxpayer is the sole stockholder, any distribution must necessarily be pro rata. If the problem were as simple as appellant would have it, the statute or the regulations would only need to say that any distribution to a sole stockholder shall be considered a taxable dividend. Needless to say, neither statute nor regulation so provides. In fact, the regulation upon which appellant so heavily relies (Appellant's Br., p. 15) clearly implies that pro rata distributions are not always taxable dividends, by saying that "generally" they are. Certainly a pro rata distribution to several stockholders presents a considerably stronger case than a distribution to a sole stockholder, for the simple reason that a distribution to a sole stockholder must, in the nature of things, be pro rata.

As the Court said in the previously cited case of *Commissioner v. Sullivan*, 210 F2d at p. 610:

"Strong as is the pro-rata factor in this case, it is not sufficient in itself to require or authorize us to set aside the findings of the Tax Court and invoke the application of Section 115(g). To do so would nullify the regulation that authorizes the complete retirement of any part of the stock, whether or not pro rata among the shareholders."

Judge Rives, dissenting, insisted that the pro rata factor should be determinative in this case, though recognizing that some of the decisions had considered the factor of business contraction or liquidation.

The appellant complains that although the fact that Colonel Woodlaw's relationship to his company and his control over it remained unchanged was "significant," it was not considered "important" by the District Court. (Appellant's Brief, p. 19) It is true that the District Court did not find this factor controlling, but he no doubt gave it the importance he felt it deserved in the over-all picture, rather than the overriding all-importance attributed to it by appellant herein.

Of the other factors relied upon by appellant, it cannot be gainsaid that there was closely held corporate stock and a failure to declare regular dividends. There is no showing, however, although earnings were large, that there were excessive accumulations of cash, prior to the inception of the liquidation program. In fact, the only evidence in the record regarding the cash position of the corporation is its 1946 tax return, which shows cash of \$19,739.66 on hand at the beginning of

the year, before any sales had been consummated. There is nothing in the record from which it may be concluded that this was unreasonable or unnecessary. The mere existence of a substantial earned surplus does not mean that working capital is excessive. The earnings of the corporation had been reinvested in capital assets.

The next factor is intention to continue in business, and actual continuation in business. Despite the lack of a corporate resolution of which appellant complains, (Appellant's Br., p. 25) the evidence is overwhelming that it was the intention of the sole stockholder to liquidate the entire business. The evidence is also overwhelming that he did liquidate a substantial part thereof, changed the nature of the balance in an effort to make it more attractive to prospective purchasers, and made extensive efforts to dispose of the balance.

The factor of motive to aid the stockholder, as well as the corporation, is a difficult problem, as we have already mentioned, but there is certainly substantial evidence that a legitimate business purpose of Woodlaw Investment Co., as a separate entity from Colonel Woodlaw, was served by the liquidation plans. As will be hereinafter shown, it has been held that the impending retirement of the manager of the business is a legitimate reason for a contraction of corporate business, and a consequent liquidation or partial liquidation. Moreover, and more significant, there is a complete absence of any individual purpose on the part of Colonel Woodlaw other than the desire to liquidate his holdings. Had there been shown an immediate need of cash

on his part, the appellant might properly contend that this liquidation served his personal purposes, and had no relation to any proper purposes of the corporation. But the fact that Colonel Woodlaw was getting too old to manage the affairs of the corporation himself and saw no prospect of a successor is at least as much a corporate as an individual purpose.

Not only is there no motive of tax avoidance, but the procedure adopted actually had the effect of incurring a capital gains tax which otherwise would not have had to be paid. Colonel Woodlaw was an old man. Had he held the stock until his death, it would have passed to his heirs at its stepped-up basis, without any capital gains tax being incurred. Internal Revenue Code of 1939, Section 113(a)(5). But apparently Colonel Woodlaw felt that the reduction of the corporate capital thereby accomplished in furtherance of his plan of liquidation justified the distribution. There is an entire absence of any other purpose for the transaction in the record.

Finally, the appellant cites as a factor "facts showing that the net effect of a purchase and retirement of stock is to distribute corporate earnings just as if a cash dividend had been declared and paid." Just what facts he refers to cannot be determined. The Code specifically provides that amounts distributed in partial liquidation shall have capital gains treatment unless "essentially equivalent to the distribution of a taxable dividend," which seems to imply that earnings may be distributed to stockholders "at such time and in such manner" as not to be treated as dividends.

## **The Distribution Was Made in Partial Liquidation of the Corporation**

The appellant, as stated in the beginning of this Brief, relies upon inferences and guesses, drawing his own conclusions from the testimony. Thus he states that the record is "devoid of any evidence of a business purpose." (Appellant's Br., p. 22) Then he asserts that the intention to liquidate the company "is not conclusively proved by the evidence." (Appellant's Br., p. 24) He suggests that if there were a legitimate business purpose "it would seem that such purpose should have been stated in the resolution" because it is customary for a corporation to indicate in its minutes that it is liquidating. (Appellant's Br., p. 25) He states, at the same page, that there is no evidence that the company intended to liquidate. He suggests that "we may properly infer" from the tax return that some business activity was carried on during the year 1946 (Appellant's Br., p. 28). And finally, he states that "we do not admit" that evidence that the company was actually in liquidation proved that it was. (Appellant's Br., pp. 29-30) Needless to state, his refusal to admit facts found by the District Court on substantial evidence is immaterial.

He also cites the case of *Beretta v. Commissioner*, 141 F2d 452 (CA 5, 1944) for the proposition that the acts and doings of the corporation are the best evidence of corporate intent to liquidate. It should be noted, in the first instance, that this case too was an affirmance of the Tax Court, and the Court of Appeals was pointing to evidence tending to support the Tax Court's findings. What it said, however, is nevertheless significant.

"There must be a manifest intention to liquidate and a continuing purpose to terminate and dissolve the corporation. Its activities must be directed to that end. The question of whether a corporation is in liquidation is not necessarily resolved by corporate resolutions, but the solution lies in the intent, to be determined by the acts and doings of the corporation. The process of liquidation is not a status that can be assumed or discarded at will, but is a condition brought about by affirmative action, the normal and necessary result of which is winding up the corporation. The adoption or failure to adopt a resolution of liquidation is not controlling. *Kennemer v. Commissioner of Internal Revenue*, 5 Cir., 96 F. 2d 177.

This leads to the inquiry, whether or not the distribution or dividend was made with the intent that the corporation would remain as a going concern or was it made with the affirmative intent to ultimately liquidate the company. *Holmby Corporation v. Commissioner of Internal Revenue*, 9 Cir., 83 F. 2d 548; *Canal-Commercial Trust & Savings Bank v. Commissioner of Internal Revenue*, 5 Cir., 63 F. 2d 619."

The act and doings of the corporation, therefore, are nothing more than evidence of the intent of the corporation at the time of the distribution. It is clear that at the time of this distribution, and for several months prior thereto, there was an intent on the part of the sole stockholder to liquidate. Moreover, the affirmative "acts and doings of the corporation" bear out this intent. Thus, there were sales of two major capital assets, and an effort made to sell the remaining capital assets. Changes were made in the operation of the business, from the corporation operating the properties itself to leasing them to others, with the intention of making

them a more desirable investment for a prospective purchaser. There can be no question but that there was substantial evidence that at the time of the transaction in question, the corporation intended to liquidate, and was taking all necessary steps to do so. The fact that a buyer with \$1,000,000 could not readily be found certainly does not disprove an intent to liquidate, and in the meantime the corporation had the properties. It had no alternative but to operate them in some manner, but the method was changed from active operation to leasing to other operators.

It is interesting to compare the position taken by appellant herein with the position taken by the Government in the cases cited in the *Beretta* case, *supra*. In each of those cases, the Board of Tax Appeals was affirmed, the Courts holding that there was substantial evidence that the distributions in those cases were made in liquidation. In those cases, the taxpayer was trying to contend that the transaction was not a liquidation.

In *Canal-Commercial Trust & Savings Bank v. Commissioner*, 63 F2d 619, 620 (CCA 5, 1933), the Court said:

“The determining element therefore is whether the distribution was in the ordinary course of business and with intent to maintain the corporation as a going concern, or after deciding to quit with intent to liquidate the business. Proceedings actually begun to dissolve the corporation or formal action taken to liquidate it are but evidentiary and not indispensable.”

In *Holmby Corp. v. Commissioner*, 83 F2d 548, 549 (CCA 9, 1936) this Court held that the findings of the

Board, being supported by substantial evidence were conclusive, and went on to point out:

"On the facts, as found, the Board's conclusion that the distributions in question were not 'dividends,' but were distributions in liquidation of a corporation was clearly correct. The fact that the distributions were called 'dividends' and were made, in part, from earnings and profits, and that some of them were made before liquidation or dissolution proceedings were commenced, is not controlling. (Citing cases.) The determining element is whether the distributions were in the ordinary course of business and with intent to maintain the corporation as a going concern, or after deciding to quit and with intent to liquidate the business."

In *Kennemer v. Commissioner*, 96 F2d 177, 178 (CCA 5, 1938) the Court stated:

"It is not material that the distribution was not specifically designated as a liquidating dividend or that no formal resolution to liquidate or dissolve the corporation had been adopted when the distribution was made. An intention to liquidate was fairly implied from the sale of all the assets and the act of distributing the cash to the stockholders . . . The determining element was the intention to liquidate the business, coupled with the actual distribution of the cash to the stockholders."

All of these cases arose under Section 115, or its predecessor, Section 201. In all of them, the Commissioner was contending that the distribution had been in connection with a liquidation. In all of them, the Courts of Appeal upheld the fact-finding of the lower court to the effect that the distributions had been made in liquidation, despite the absence of formal corporate action. All of them hold that the determinative factor

is the intent to liquidate. Despite the appellant's differing interpretations, there was substantial evidence from which the District Court could and did find that there was an intent to liquidate in this case.

Appellant correctly points out that "as sole stockholder and president of the Woodlaw Investment Company, Woodlaw could, of course, have paid dividends at any time." (Appellant's Br., p. 20) He apparently refuses to recognize the equally obvious proposition that as sole stockholder, and president of the corporation, Colonel Woodlaw could have liquidated any time that he intended to, and the record is overwhelming that starting in December of 1945, that was precisely what he intended. We do not think it was far-fetched for the Court to impute the same intention to the corporation, even in the absence of a resolution, when every major corporate activity from that time onward was taken with a view toward liquidation and was consistent with an intent to liquidate. Colonel Woodlaw died before he had succeeded in finding a purchaser for this million-dollar property, and consequently the liquidation was never carried out.

Despite the fact that the liquidation was not completed, there was clearly a partial liquidation within the code definition. (Sec. 115(i) quoted in Appellant's Br., p. 32)

Aside from arguing that there was no liquidation in this case, appellant's sole point is that even if there was, there is no evidence of any connection between the intention to liquidate and the retirement of the

stock. We feel that the timing alone is sufficient to justify the District Court in holding that there was such a connection. We have here a man who had actively operated a business for years and had reached an advanced age. In November, 1945, a beloved son, whom he had expected to succeed him, suddenly is killed. In December, he forms a plan to liquidate his business, and sales of property are made in pursuance of that plan in January\*, in February, in April and in May of the year immediately following. Leases are executed in pursuance of the plan in 1946 and 1947. Efforts are made to sell the balance of the property. Similarly, in February of 1946, the 3500 shares of stock were reduced to 2800. A few days later, the transaction here in question took place. Is it "clearly erroneous" for the District Court to infer that this too was a part of the liquidation plan? Every other activity in which the corporation is shown to have engaged during the period is consistent with liquidation; why should this be the only exception?

**The Courts Have Held That a Policy of Contraction of the Business, the Advanced Age of the Managing Stockholder, or a Partial Liquidation, Are Sufficient Business Reasons for a Distribution, Preventing the Application of Section 115(g).**

Each case under this section of the code must be determined upon its own facts. As the Court stated in *Jones v. Griffin*, 216 F2d 885, 887 (CA 10, 1954):

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\*See note, p. 6.

"No inflexible and unyielding rule of thumb has been devised for ready use in determining in every instance whether a transaction constituted a partial liquidation within the scope and meaning of section 115(c), or was the equivalent of a taxable dividend within the purview of section 115(g). A critical examination of the statute negates the suggestion that a weighted formula can resolve the crucial question in every case. But certain criteria are recognized for determining the question."

The Court thereupon sets forth some of the relevant criteria, including some of those mentioned by appellant in his Brief.

In view of the dependence of each decision upon its peculiar facts, we do not wish to present an exhaustive analysis of the cases holding that a distribution in particular cases is not the equivalent of a taxable dividend. We present, therefore, a brief summary of some of the relevant cases, showing the facts present in the instant case have been relied upon to uphold the factual determination of the trial courts in finding that there was not equivalence to a dividend, or, in the case of lower court decisions, to arrive at that conclusion.

In *Commissioner v. Sullivan*, 210 F2d 607 (CA 5, 1954) the Court held that the Tax Court did not err in finding that a pro rata distribution to the only two stockholders was not essentially equivalent to the distribution of a taxable dividend. The Court, pointing out that the "net effect" test was nothing more than a paraphrase for essentially equivalent, held that the contraction in the company's business justified the redemption of a portion of the corporation's capital stock.

In *McDaniel v. Commissioner*, 25 TC No. 39, Nov. 22, 1955, the Tax Court held that a distribution to the sole stockholder was not a taxable dividend. The circumstances of the case are exceedingly close to the case before this Court. The corporation had accumulated earnings. No resolution of liquidation was passed by the Board of Directors. The Tax Court found, however, that the corporation had been in the process of complete liquidation since 1941, the distribution in question having been made in September, 1948. As of 1954, the corporation had still not been dissolved.

The Tax Court pointed out that "There is room for the operation of both sections 115(c) and 115(g)." Finding that the corporation had consistently contracted its business and had pursued a policy looking forward to complete liquidation, the Tax Court determined that the net effect of the distribution was a partial liquidation, despite the fact that as of the time of the hearing, the corporation had not been liquidated, and no resolution of liquidation had ever been adopted.

In *Keefe v. Cote*, 213 F2d 651 (CA 1, 1954) the First Circuit affirmed a jury verdict that there was no essential equivalence to a dividend, although finding that the distribution in question had been substantially pro rata, and that there was no policy of contraction or partial liquidation. The Court held that the existence of a legitimate business purpose for the issuance and redemption of the stock was sufficient to permit the trier of the facts to determine that the distribution was not essentially equivalent to a dividend. In the par-

ticular case, the stock was issued to the taxpayer in payment of a note which the corporation owed him, in order to improve the corporation's credit position. It was redeemed in order to enable him to repay the money which he owed his mother on the purchase of her stock in the corporation. The taxpayer, who was the only substantial stockholder, testified that at the time the stock was issued to him it was understood that it would be redeemed when the corporation could conveniently do so.

In *Commissioner v. Straub*, 76 F2d 388 (CCA, 3, 1935), the facts, which were again very similar to those here involved, were summarized by the Court as follows:

"In this case we have a close family business which had accumulated a large surplus and was desirous of gradually liquidating its assets and going out of what had once been a highly prosperous, but was now a losing, business. The Commissioner determined the payments made to the taxpayer constituted dividends and not partial liquidation. On appeal, the Tax Board held with the taxpayer, and the Commissioner took this appeal."

The Court held that there was evidence to justify the Board in its decision, and in language particularly pertinent to the present case, quoted from the Board's decision as follows:

"It is entirely consistent with a purpose to liquidate that the corporation and its management should continue the operation of the business as long as there was a reasonable justification for their judgment that this was the wisest course."

In another case which contains elements of similarity to the present one, the Fifth Circuit reversed the de-

termination of the Board of Tax Appeals in holding that a particular distribution was a dividend. In *Bynum v. Commissioner*, 113 F2d 1 (CCA 5, 1940) the taxpayer received what was designated as a liquidating dividend. The commissioner contended that the company was still doing business, because it retained a piece of realty and would not sell it for \$200,000. The Court held that the liquidators had the discretion to hold out for \$300,000 if they considered that a fair price.

In *Upham v. Commissioner*, 4 T. C. 1120 (1945) the advanced age of the two chief stockholders, who were contemplating the liquidation of their corporation, was held to be a sufficient business reason to justify a partial distribution by the corporation. Redemption under such conditions was held not essentially equivalent to the distribution of a taxable dividend.

In *Imler v. Commissioner*, 11 T. C. 836 (1948), the corporation had not paid a dividend since 1934. In December, 1941, a fire destroyed part of its building. The insurance proceeds were insufficient to cover the cost of rebuilding. The excess insurance proceeds were distributed pro rata to the three shareholders in redemption of a portion of their stock. The Court held that the contraction of business and reduction in the amount of capital used constituted a legitimate reason for reducing the capital and held the distribution not equivalent to a dividend.

In *Maguire v. Commissioner*, 222 F2d 472 (CA 7, 1955) the Tax Court was reversed in holding that there was a distribution equivalent to a dividend, the Com-

missioner arguing that there was no evidence of a final decision or settled purpose to liquidate. The Court held that the undisputed facts proved an intention to liquidate, a cessation of all business activities except those essential to liquidation, and a continued and undeviating process of liquidation. The Court stated:

"While we do not disagree with the Commissioner's contention that the length of time actually consumed in carrying out a purported plan of liquidation is an element to be considered, we do not believe that there is any inflexible element in the time factor, especially where a plan calls for liquidation through a series of distributions. . . . we must recognize that while the size and intricacies of operation of one corporation might reasonably require but a year or two for its orderly voluntary liquidation, many years might reasonably be required for such a liquidation of another corporation . . . While we do not believe that, as a practical matter, the shareholders might not change their minds and reject any liquidation plan, even after it has been partially executed, we find no such action or even intention to so act in this case."

It thus appears that the elements upon which appellee here relies—the advanced age of the sole stockholder, the intention to liquidate the corporation, the carrying on of activities consistent with the intention to liquidate, and a general policy of contraction of the corporate business, have all been held to be significant factors in affirming or concluding that a distribution did not fall within the scope of Section 115(g). The factors relied upon by appellant—the pro rata distribution and the failure to complete the liquidation within a short period of time, have been rejected in particular

cases as not obviating this conclusion. Therefore, we submit that the finding of the trial court in this case is supported by substantial evidence, showing facts which have been held to prevent the application of Section 115(g), and is not clearly erroneous.

### **The Cases Cited by the Commissioner Do Not Support the Reversal of This Decision**

It is universally held that the question with which we are here concerned is one of fact. It has also been frequently pointed out that no general rule or formula covers all situations, and that each case must be decided on its own particular facts. *McGuire v. Commissioner*, 84 F2d 431, 432 (CCA 7, 1936) With these rules in mind, the Courts have been extremely slow to set aside the factual determination of the trial courts regarding the essential equivalence to a dividend of a particular distribution. Appellant has not cited in the body of his Brief a single case in which it was held that the trial court's factual determination was erroneous. The only two cases he presents in which the trial court was reversed involved questions of law. In *Jones v. Dawson*, 148 F2d 87 (CCA 10, 1945), the Court held that Section 115(c) had no application because there had been no redemption of the stock involved. In *Commissioner v. Roberts*, 203 P2d 304 (CCA 4, 1953) the Court held that the trial court erred in finding that a distribution made to one stockholder who had purchased stock from his brother's estate was in reality made to the estate. In every other appellate court decision cited by

the appellant, the factual determination of the trial court was affirmed.\* The rules and formulas set forth in those decisions simply set forth criteria under which the Court could say that the decision of the trial court was not clearly erroneous. Not one holds that the criteria there laid down are the exclusive tests.

Thus it appears that appellant has not presented a single authority holding, on any state of facts whatever, that the factual determination of the trial judge was erroneous. He has not presented a single authority in which there actually was a redemption from the particular taxpayer involved in which there has been a reversal on the ground that it was clearly erroneous to hold that a distribution was not substantially equivalent to a dividend. There may be such cases. Appellant's attorneys, however, who are presumably familiar with this field, have not thought any of them sufficiently relevant to cite in their opening brief. To paraphrase appellant's argument (see bottom of p. 29 of Appellant's Brief): It is apparent that appellant's attorneys do not believe that there is any such authority, and neither do we.

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\**Chandler's Estate v. Commissioner*, 228 F2d 909 CA 6, 1955); *Flanagan v. Helvering*, 116 F2d 937 (CADC, 1940); *Vesper Co. v. Commissioner*, 131 F2d 200 (CA 8, 1942); *Hirsch v. Commissioner*, 124 F2d 24 (CCA 9, 1941); *Smith v. United States*, 121 F2d 692 (CA 3, 1941); *Boyle v. Commissioner*, 187 F2d 557 (CA 3, 1951); *Rheinstrom v. Conner*, 125 F2d 790 (CA 6, 1942); *Hyman v. Helvering*, 71 F2d 342 (App DC, 1934), cert. den., 293 U.S. 570; *Beretta v. Commissioner*, 141 F2d 452 (CA 5, 1944).

## CONCLUSION

Whether it would have been reversible error for the District Court to decide that the distribution involved in this case was essentially equivalent to the distribution of a taxable dividend, is an issue that is not involved in this case. The sole question presented is whether the District Court's determination that this was not such a dividend can be characterized as clearly erroneous.

We believe that there was substantial evidence from which the District Court was entitled to believe that the corporation was in liquidation from December, 1945, until the date of Colonel Woodlaw's death. Despite the contentions of appellant, there is not a single activity in which the corporation is shown to have engaged after that period which was not consistent with, and in furtherance of that purpose.

We further contend that the District Court was correct in concluding that the distribution here made was in furtherance of that plan, and that it was essentially a distribution of capital assets. There is no evidence that the distribution served any individual purpose of the taxpayer, other than his desire to liquidate his holdings because of his age, which was a legitimate corporate as well as individual purpose. He was an old man, and the stock in the corporation could have passed on to his heirs in his estate at a stepped-up basis without tax. The appellant's contention that the distribution served only the individual purposes of the taxpayer would have more force if there was a single iota of

evidence that he was in need of cash, or had any individual purpose to be served by the distribution.

Moreover, a substantial part of the payment for the stock, over \$60,000, was actually made by the distribution in kind of the seller's equity in the contract for the sale of one of the capital assets.

In conclusion, then, the District Court's decision is supported by substantial evidence of a legitimate corporate purpose and an actual program of liquidation undertaken and partially consummated. The judgment of the Court below is not clearly erroneous, and should be affirmed.

Respectfully submitted,

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